No. 91-7804

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

SHELDON B. BUFFERD,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR AMICI CURIAE CHARLES T. GREEN AND KAY E. GREEN, ET AL., IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici curiae are the Petitioners-Appellants in *Charles T. Green and Kay E. Green, et al. v. Commissioner*, 963 F.2d 783 (5th Cir. Consolidated No. 90-4629, June 22, 1992). *Amici curiae* were minority shareholders in electing small business corporations (until 1983, referred to as

"Subchapter S corporations").[1] These shareholders claimed deductions on their Forms 1040 for their pro rata share of losses reported by the Subchapter S corporations in 1977, 1978 and 1979. At the request of the Internal Revenue Service ("IRS"), each of *amici curiae* signed extensions of the three-year statute of limitations on assessment of additional tax for those years; no such extensions were signed by the Subchapter S corporations whose losses were reported on the individual tax returns of *amici curiae*.

After the IRS issued notices of deficiency claiming additional income tax from *amici curiae*, they each timely petitioned the United States Tax Court for a redetermination of the tax alleged to be due. Certain of the cases of *amici curiae* were tried on fully stipulated facts which presented only one issue of law to the Tax Court: whether that court would adhere to its decision in *Kelley v. Commissioner*, T.C. Memo 1986-405, in light of the reversal of that decision by the Ninth Circuit Court of Appeals. 877 F.2d 756 (1989). The Tax Court refused to follow the Ninth Circuit (*Brody v. Commissioner*, T.C. Memo 1991-78), and these *amici curiae* appealed to the Fifth Circuit.[2]

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1 After the effective date of the Subchapter S Revision Act of 1982, P.L. 97-354, 96 Stat. 1669, the electing small business corporations which had been commonly known as "Subchapter S corporations" became designated by statute as "S corporations." 26 U.S.C. Section 1361(a)(2), Internal Revenue Code of 1986, as amended.

2 In addition to Mr. and Mrs. Green, *amici curiae* include Robert White and Jean R. White (Nos. 90-4630 and 90-4631), Gene C. Elkins and Louise Elkins (No.90-4632), R.Talley Melton and Carolyn Melton (No. 90-4847), Bobby L. Davis and Ramona A. Davis (No.90-4849), James R. Graves and Elizabeth J. Graves (No. 90-4850), Don C. Quast and Audrey N. Quast (No. 90-4851), Elizabeth C. Mayfield (No. 90-4852), Jack E. Blanco and Jeanne Blanco (No. 90-4853), and Martin Brody and Jerrilyn Brody (No. 90-91-4497). Norman C. Way and Mary K. Way (No. 90-4848) and Mike Kane and Sandra Ann Kane (No. 90-4881), who were parties in the *Green* case in the Fifth Circuit, are not included herein as *amici curiae*. By stipulation in the United States Tax Court, the decisions in ten additional cases were not appealed to the Fifth Circuit but are tied to the outcome of the *Brody* case.

In Consolidated Docket No. 90-4629, 963 F.2d 783 (5th Cir. 1992), the Fifth Circuit declined to follow the *Kelley* decision of the Ninth Circuit, holding instead that the three-year statute of limitations applicable to assessments of additional income tax attributable to his or her investment in a Subchapter S corporation is the three-year statute of limitations pertaining to the individual's return, not the return of the Subchapter S corporation.[3] On the same day that the Fifth Circuit issued its opinion, this Court granted certiorari with respect to the Second Circuit's identical conclusion as to this statute of limitations question. *Bufferd v. Commissioner*, 952 F.2d 675 (2d Cir.), *cert. granted*, _ U.S.__, 112 S. Ct. 2990 (1992)(No. 91-7804). Since the

3 The balance of the *amici curiae* had Tax Court decisions entered against them based upon a common settlement offer made by the Commissioner of Internal Revenue. More than 90 days after those decisions were entered, these *amici curiae* filed motions for leave to file motions to vacate the decisions, based upon the holding of the Ninth Circuit in *Kelley*. The Tax Court denied the motions, ruling that in the absence of any allegations of fraud on the court, it had no jurisdiction to vacate otherwise final decisions. These *amici curiae* also appealed to the Fifth Circuit. Because the Fifth Circuit ruled against *amici curiae* with respect to the statute of limitations issue, it did not reach the issue regarding whether, in the absence of fraud on the court, the Tax Court had jurisdiction to vacate a decision more than 90 days after entry. The position of *amici curiae* was that the jurisdictional issue is controlled by the Fifth Circuit's prior holding in *La Floridienne J. Buttgenbach & Co. v. Commissioner*, 63 F.2d 630 (5th Cir. 1933).

controlling issue in the cases of *amici curiae* is identical to that in ***Bufferd***, *amici curiae* file this brief in support of Petitioner herein.[4]

This brief *amici curiae* in support of Petitioner is submitted with the consent of the parties, as provided in Rule 36.2, Rules of the Supreme Court of the United States.

SUMMARY OF ARGUMENT

I.

A. In interpreting federal statutes, including tax statutes, courts have a duty to look first to the literal language of the statutes and assume that Congress meant exactly what it said. If a natural reading of the statutes does not give rise to absurd results, courts must apply statutes as written.

B. A natural reading of the three statutes at issue requires the conclusion that when the IRS proposes changes to a Subchapter S corporation's income or loss, the statute of limitations commences upon the filing of the corporation's return. The reasoning is as follows: while a Subchapter S corporation is not (by virtue of Section 1372(b)(1)) subject to income tax, and therefore is not required (by Section 6012(a)(2)) to file an income tax return, under Section 6037

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4 Petitioner should never have had to address the Subchapter S issue on which Second Circuit decided the case. Petitioner executed an extension of the statute of limitations that was limited to adjustments to distributive shares in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)." 952 F.2d at 678. Such a limited extension of the statute of limitations should not encompass the net operating loss reported on Petitioner's return attributable to his ownership of a Subchapter S corporation. *See, e.g., Armco, Inc. v. Commissioner*, 88 T.C. 946 (1987); *Bauer v. Commissioner*, T.C. Memo 1992-257; *Russello v. Commissioner*, T.C. Memo 1989-391.

its net income or net loss is reported on an information return. That information return, by the very language of Section 6037, is a corporate return filed pursuant to Section 6012 for statute of limitations purposes. Consequently, when the IRS proposes changes to a Subchapter S corporation's net income or net loss, it must raise the issue within the three-year statute of limitations that commences when the corporate return is filed. Legally, if the IRS permits the three years to pass after a Subchapter S corporation's return is filed without proposing changes, that failure is a determination that no additional taxes are due with respect to the Subchapter S corporation's return.

C. The court below held that Section 6501(a)'s three-year statute of limitations on assessment could only refer to the "return" of the person, *i.e.*, the shareholder, whose liability is being assessed. However, Section 6501(a) does not specify whose return is at issue, nor does it address against whom assessment is to be directed. The last sentence of Section 6037 supplies the answer to whose return is at issue--the return of the Subchapter S corporation--and the substantive provisions of Subchapter S direct that the liability associated with that return is that of the shareholder. For these reasons, for the IRS to timely propose changes to a return of a Subchapter S corporation, the three-year statute of limitations with respect to that return must be open; to assess the tax attributable thereto, the three-year statute of limitations with respect to the shareholder must also be open.

II.

A. Legislative history properly may be consulted only when a patent ambiguity exists in the statute. Even though there is no ambiguity in the three statutes at issue, two courts of appeals resorted to language in the legislative history of Section 6037, in which an "example" is given.

Those two courts of appeals concluded that the "example" set out in the legislative history was not an "example" at all, implying that the Senate Finance Committee misspoke. Those courts concluded that the "example" expresses the only instance in which the statute of limitations commences with the filing of a Subchapter S corporation's return. Such conclusion if legally erroneous.

B. After ignoring the "for example" language in the Senate Finance Committee's report, the Second, Fifth and Eleventh circuits, to reach a conclusion in favor of the government, then read Section 6037 by eliminating the word **"any"** in the following context: the last sentence of Section 6037 states: **"Any** [Subchapter S corporation] return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012." (Emphasis added.) Those circuits held, in effect, that only one type of Subchapter S return, one in which the Subchapter S election is defective, is treated as a corporate return for statute of limitations purposes. In normal English, "any" encompasses each and every return filed by a Subchapter S corporation, whether taxable or not or whether it had made a defective Subchapter S election or not. In effect, then, these three courts "interpreted" Section 6037 as though Congress had not inserted the word "any" in the statute.

C. The attempt to limit the construction of the last sentence of Section 6037 to the "example" cited in the legislative history of that section, coupled with the reading of "any" out of Section 6037 itself are the legal errors that lead to the erroneous conclusions in the court below. The Ninth Circuit's *Kelley* opinion correctly analyzed the three statutes at issue and harmonized the legislative history with those statutes.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE CONTROLLING STATUTES IN THE INTERNAL REVENUE CODE DIRECTS THAT THE STATUTORY PERIOD FOR ASSESSING ADDITIONAL INCOME TAX AGAINST SHAREHOLDERS OF A SUBCHAPTER S CORPORATION FOR ADJUSTMENT TO THE SUBCHAPTER S CORPORATION'S RETURN COMMENCES WITH THE FILING OF THE CORPORATE RETURN.

A. In Interpreting the Meaning of Statutory Phrases, the Words of the Statutes Are to Be Accorded Their "Plain Meaning" Unless a "Natural Reading" of Those Words Leads to an Absurd Result.

This Court granted certiorari, __ U.S.__,112 S. Ct. 2990 (1992), to resolve the conflict among the courts of appeals as to whether the "return" which starts the statute of limitations on assessment of tax deficiencies attributable to the "flow-through" of Subchapter S corporation income or loss is the "return" of the corporation or the "return" of the individual shareholder. It is the view of *amici curiae* that the plain language of the Internal Revenue Code leads to the conclusion that the statute of limitations commences with the filing of the corporate return.

In the interpretation of a federal statute, the duty of courts is to construe the language of the statute so as to give effect to the intent of Congress as expressed in that statute. In fulfilling this duty, courts must look first to the literal

meaning of the words employed in the statute, *Flora v. United States*, 357 U.S. 63, 65 (1958), using a "natural reading," *Patterson v. Shumate*, ___ U.S. ___, 112 S. Ct. 2242, 2246 (1992), and assuming "that Congress said what it meant and meant what it said." *Pettis ex rel. United States v. Morrison-Knudsen Co.*, 577 F.2d 668, 672 (9th Cir. 1978). When statutory language is not ambiguous and does not lead to absurd results, courts must apply the statutes as written. *Arline v. School Bd.*, 772 F.2d 759, 762 (11th Cir. 1985), *aff'd*, 480 U.S. 273 (1987). The job, then, is to determine the "natural reading" and plain meaning of the three statutes at issue. *Amici curiae* will demonstrate that their plain meaning is that the statute of limitations with respect to the Subchapter S corporation's return governs any adjustments to income or loss originating on that return.

B. The Interrelationship Among the Three Statutes at Issue Constitutes a Clear Directive that the Subchapter S Corporation's Return Is the Controlling Return when the IRS Decides to Adjust Income or Loss on that Return.

For the 1979 taxable year at issue in Petitioner's case, if a corporation made an election to be taxed as a Subchapter S corporation, its income or loss would be reported on its own tax return, but the tax liability (or tax benefits) associated with the Subchapter S corporation's return would be a liability of (or a benefit to) the corporation's shareholders, pro rata to their share ownership. Section 6037[5]; Section 1372(b)(1); Section 1373(b); Section 1374(b). As a consequence, the effect of Subchapter S corporation

5 All citations to "Section" are to the Internal Revenue Code of 1954, as amended and effective for the 1979 year, codified at 26 U.S.C., unless specifically stated to the contrary.

status is that "such corporation shall not be subject to the taxes imposed by this chapter * * *." Section 1372(b)(1). The "chapter" reference in Section 1372(b)(1) is to Chapter 1 of the Internal Revenue Code of 1954, as amended, entitled "Normal Taxes and Surtaxes." Chapter 1 is a part of Subtitle A, which is entitled "Income Taxes."

Since the Subchapter S corporation is not subject to income taxes, the next issue is whether such corporation must file a tax return. The statute specifying which taxpayers must file income tax returns is Section 6012.[6] In pertinent part, Section 6012(a) commands that "[r]eturns with respect to income taxes under subtitle A shall be made" by certain persons enumerated by the subsections of the statute. Thus, Section 6012(a)(1) requires individuals having gross income in excess of the exemption amount to file returns, and Section 6012(a)(2) requires "[e]very corporation subject to taxation under subtitle A" to file returns.

Since, by virtue of Section 1372(b)(1), a Subchapter S corporation is not subject to income taxes, at first blush it appears that under Section 6012(a)(2) it cannot be a "corporation subject to taxation under subtitle A," and thus has no duty to file an income tax return. However, this conclusion ignores another mandate, Section 6037, which for the year at issue, stated:[7]

6 Section 6012 is placed in Subtitle F, "Procedure and Administration," Chapter 61, "Information and Returns," Subchapter A, "Returns and Records," Part B, "Income Tax Returns," Subpart II, "Tax Returns or Statements."

7 Section 6037 is placed in Subtitle F, "Procedure and Administration," Chapter 61, "Information and Returns," Subchapter A, "Returns and Records," Part III, "Information Returns," Subpart A, "Information Concerning Persons Subject to Special Provisions."

> Every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year * * *. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

Congress placed Section 6037 in the part of the Internal Revenue Code addressing information returns. Because (under Section 1372(b)(1)) Subchapter S corporations are not subject to taxation, and only corporations subject to taxation are required to file returns "with respect to income taxes" (Section 6012(a)(2)), it is clear that the return contemplated by Section 6037 is an information return, not a tax return for a taxable corporation.[8]

That conclusion that a Subchapter S corporation return is an information return (not a tax return) is, of course, completely consistent with the genesis of Subchapter S. At the time that Subchapter S was added to the Internal Revenue Code, it was impossible for a Subchapter S corporation as such to be taxable: it was a fully "flow-through" entity, whose net income or net loss was treated as

8 Petitioner takes the position that the return filed by the Subchapter S corporation is an income tax return, not an information return. It is true, as Petitioner argues, that there are substantial differences in form between the return filed by a Subchapter S corporation and the return filed by a partnership. Whatever the nature of the return filed by a Subchapter S corporation, one thing is clear: by virtue of the last sentence of Section 6037, any Subchapter S corporation's return is "treated" as a return filed under Section 6012 for the sole purpose of applying the statute of limitations and thus it is, for that purpose, deemed to be a return "with respect to income taxes under subtitle A." Section 6012(a).

the income or loss of the shareholder.[9] Technical Amendment Act of 1958, Pub. L. No. 85-866, § 64(a), 1985 U.S.C.C.A.N. (72 Stat. 1606) 1925, 1980.

Even though a Subchapter S corporation's return is an information return, in Section 6037, Congress mandated, for statute of limitations purposes, that such information return be treated as an income tax return: "Any return filed pursuant to this section shall, for purposes of chapter 66[10] (relating to limitations), be treated as a return filed by the corporation under section 6012."[11] The reference to

2 Subchapter S corporations did not themselves become subject to taxation until eight years after enactment of Subchapter S. On March 2, 1966, a Subchapter S corporation became subject to one corporate-level tax, the tax on net capital gains of Section 1378. S. Rep. No. 1007, 89th Cong. 2d Sess. 1 (1966), *reprinted in* 1966 U.S.C.C.A.N. 2141, 2146. This was the only corporate-level tax applicable to Subchapter S corporations during the 1979 year at issue herein.

Subsequently, Congress has chosen to add additional corporate-level taxes to Subchapter S. These include the tax on built-in gains, the tax on excessive passive investment income, and the recapture of deferred income generated by use of the last-in, first-out method of inventory identification. 26 U.S.C Sections 1374, 1375 and 1363(d), Internal Revenue Code of 1986, as amended.

10 Chapter 66 appears in Subtitle F, "Procedure and Administration," Chapter 66, "Limitations," Subchapter S, "Limitations on Assessment and Collection."

11 As stated in footnote 9, when enacted, there were no corporate-level income taxes applicable to Subchapter S corporations. Nor were any corporate-level penalty taxes applicable to Subchapter S corporations. For example, Section 6651, entitled "Failure to File Tax Return," as it existed in 1958, did not impose a penalty upon the non or late filing of a Subchapter S return. The statute provided:

> In case of failure to file any return required

"limitations" in Section 6037 is to Section 6501(a), the governing statute of limitations on assessment of income taxes, which specifies that income taxes must be assessed "within 3 years after the return was filed * * *." However, with respect to IRS audit adjustments relating solely to Subchapter S items, Section 6501(a) does not address *which* return--the corporation's or the shareholder's--commences the three-year period. Section 6037 answers that question when it provides that the Subchapter S corporation's information return shall "be treated as a return filed by the corporation under section 6012," *i.e.*, as the income tax return of a corporation that is subject to tax which is required to file an income tax return pursuant to Section 6012(a)(2).

The unmistakable result of the interplay of these three statutes--Section 6012(a)(2), Section 6037 and Section 6501(a)--is to foreclose IRS audit adjustments to income or loss originating on a Subchapter S corporation's return after three years from the date of filing that return, even if the return for the individual shareholder remains subject to audit. This is because once the statute of limitations has run on the Subchapter S corporation's return, that expiration, itself, is a determination that no additional tax is due **with respect to** the Subchapter S corporate return. *E.g.*, *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989); *Diamond Gardner Corp. v. Commissioner*, 38 T.C. 875 (1962); *Estate*

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under authority of subchapter A of chapter 61 (other than part III hereof), [a penalty shall be imposed].

The referenced Part III governed information returns and included Section 6037, the provision requiring a Subchapter S return to be filed. Since Section 6651 appeared in Chapter 68, "Additions to the Tax, Additional Amounts, and Assessable Penalties," rather than Chapter 66 (relating to limitations), the corporate income tax return treatment given to Subchapter S corporation returns by the last sentence of Section 6037 would not apply.

of King v. Commissioner, T.C. Memo 1991-151.

C. The Commissioner's Reading of the Controlling Statutes Creates Ambiguity Where None Exists.

Given the clarity of the relevant statutes, the Commissioner "bears an 'exceptionally heavy' burden of persuading [the Court] that Congress intended to limit" the word "return" in Section 6501(a) to the return of the individual shareholder, rather than the return of the Subchapter S corporation. *Patterson v. Shumate*, _____ U.S. _____, 112 S. Ct. 2242, 2248 (1992). In attempting to meet this burden, the government argued below, and the Second Circuit held, that the "return" to which the statute of limitations applies is the return of the individual whose liability is being assessed, and not that of an entity whose return reports the transaction that gives rise to the liability. *Bufferd v. Commissioner*, 952 F.2d 675, 677, *citing Siben v. Commissioner*, 930 F.2d 1034, 1035 (2d Cir.), *cert. denied*, _____U.S._____, 112 S. Ct. 429 (1991). The Second Circuit stated that "Section 6501(a) does not bar adjustments to an entity's return that do not result in a tax assessment on that entity." *Bufferd*, 952 F.2d at 677.

The Second Circuit has misinterpreted Section 6501(a), which simply states that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * *." In the context of a Subchapter S corporation, Section 6501(a) does not address whose *return* is at issue, nor does it address against *whom* assessment is to be directed.

But this lack of guidance in Section 6501(a) is remedied by the substantive provisions of Subchapter S. According to Section 1373(a), "[t]he undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation in the manner and to the extent set forth in this section." If the Subchapter S corporation were profitable during the year, each shareholder must report his or her pro rata share of the corporation's income as a dividend. Section 1373(b). If the Subchapter S corporation experienced a loss during the year, each shareholder must report his or her share of the corporation's loss as a net operating loss attributable to the trade or business in which the corporation was engaged. Section 1374(b).[12]

Thus, income subject to tax or the loss that may be deducted as a result of the operations of the Subchapter S corporation is computed at the level of the Subchapter S corporation, and the running of the statute of limitations with respect to the corporate return fixes the amount of that income or loss from the Subchapter S corporation; such running itself is a determination that no additional tax is due **with respect to such return**. *E.g.*, *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989); *Diamond Gardner Corp. v. Commissioner*, 38 T.C.,875 (1962); *Estate of King*

12 Accordingly, taxable income or loss of a Subchapter S corporation was computed in almost the same manner of a taxable corporation. After enactment of the Subchapter S Revision Act of 1982, P.L. 97-354, 96 Stat. 1669, each item making up the income or loss of an S corporation maintained its character as such and was treated as earned or incurred directly by the shareholder. 26 U.S.C. Section 1366(b), Internal Revenue Code of 1986, as amended. After 1982, adopting the partnership scheme, S corporation income and expense items were not netted together to produce one bottom-line dividend (in the event of a net gain) or net operating loss (in the event of a net loss).

v. Commissioner, T.C. Memo 1991-151. On the other hand, since by statute the IRS must look to the shareholder for assessment of the tax liability attributable to the Subchapter S corporation's return, the statute of limitations on assessment applies at the shareholder level.[13]

13 Because the last sentence of Section 6037 treats a Subchapter S corporation's return as a corporate return for statute of limitations purposes, the Commissioner's reliance in the lower courts on *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957), is misplaced. In that case this Court held that information returns filed by a purportedly non-profit club **did not** constitute returns for purposes of the three-year statute of limitations on deficiency assessment of income taxes. The actual result of *Automobile Club* has since been reversed by statute. 26 U.S.C. Section 6501(g), enacted as part of the Internal Revenue Code of 1954, H.R. 8300, "A Bill to Revise the Internal Revenue Laws of the United States." However, for circumstances not governed by Section 6501(g), the holding continues to be good law. Since the automobile club did not qualify for tax exempt status, it was taxed as a regular corporation, which must file an income tax return pursuant to Section 6012(a)(2).

In that regard, the facts of *Automobile Club* are very much like an invalidly electing Subchapter S corporation, which would also be taxed as a regular corporation. Since Section 6501(g) has no application to Subchapter S returns, the holding of *Automobile Club* would say that the Subchapter S corporation return is not a return for statute of limitation purposes. However, the application of *Automobile Club* to the invalidly-electing Subchapter S corporation is expressly precluded by statute: the last sentence of Section 6037 says that, among other situations, the Subchapter S corporation's information return shall, for limitations purposes, be treated as a return of the corporation.

The holding in *Automobile Club* was mandated by the definition of a return as a filing with sufficient data to compute and assess the tax liability of the enterprise. 353 U.S. at 188. Since the information returns at issue therein did not contain such data, they did not constitute returns. Contrast the requirements in Section 1373(d) and Section 1374(c), which state that taxable income of a Subchapter S corporation is computed to give rise to one number as the income or loss of the

The net result of the treatment (under Section 6037) of the Subchapter S corporation's return as a corporate income tax return is that for the IRS to make audit adjustments to a Subchapter S corporation's return, its statute of limitations must be open; to assess the liability associated therewith from the shareholder, his or her statute of limitations must be open as well. Simply stated, in order to adjust tax liability, the IRS must be able to do so at the Subchapter S level, *i.e.*, the source of the income, or else the IRS will be prevented from doing so at the point where the income is taxed. *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989); *Fendell v. Commissioner*, 906 F.2d 362 (8th Cir. 1990)(expiration of the statute of limitations with respect to a trust barred adjustment to the trust beneficiary's return); *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989)(no transferee liability may be asserted against an estate beneficiary for estate taxes after the expiration of the statute of limitations for the estate taxes had expired); *Boatmen's First Nat'l Bank v. United States*, 705 F. Supp. 1407 (W.D. Mo. 1988)(the Commissioner cannot revalue gifts for the purpose of calculating estate tax after the expiration of the statute of limitations on the gift tax return).[14]

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corporation, which is then reported by the shareholders pro rata to their stockholdings. Since for limitations purposes, this Subchapter S corporation return is a corporate return pursuant to Section 6037, the fact that a Subchapter S corporation return might or might not contain sufficient data to compute and assess a tax liability at the corporate level is irrelevant. *But cf.*, *Roschuni v. Commissioner*, 44 T.C. 80, 85 (1965)(a Subchapter S corporation's return is merely an adjunct to the return of the individual shareholders and must be considered as part of the shareholders' returns).

14 In 1982, Congress enacted a new method of auditing partnerships and Subchapter S corporations. Because these amendments were codified by the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248 (96 Stat. 324), they often are referred to as the "TEFRA" or "entity-level" audit rules. 26 U.S.C. Sections 6221-6233, Internal Revenue Code of 1986, as amended (partnership audit provisions); 26 U.S.C. Sections 6241-6245, Internal Revenue Code of 1986, as amended (S corporation audit provisions). The effect of this enactment is to remove the dual statute of limitations issue addressed in this brief. Post-1982, the statute of limitations is applied only at the partnership level or the S corporation level, unless the entity is not subject to those rules because it is a "small" partnership or a "small" S corporation. 26 U.S.C. Section 6231(a)(1)(B) and 26 U.S.C. Section 6244, Internal Revenue Code of 1986, as amended.

II. A CAREFUL REVIEW OF LEGISLATIVE HISTORY DEMONSTRATES THAT THE STATUTE OF LIMITATIONS FOR ADJUSTMENTS TO SUBCHAPTER S CORPORATION INCOME OR LOSS COMMENCES WHEN THE SUBCHAPTER S CORPORATION FILES ITS RETURN.

A. The Fifth and Eleventh Circuit Courts of Appeals in *Green* and *Fehlhaber* Have Rewritten the Last Sentence of Section 6037 by Reference to a Single Example in the Legislative History of that Section that by its Wording Does Not Purport to Constitute the Only Application of the Sentence.

Although courts "appropriately may refer to a statute's legislative history to resolve statutory ambiguity," *Toibb v. Radloff*, _____U.S._____, 111 S. Ct. 2197, at 2200 (1991), statutory clarity "obviates the need for any such inquiry." *Patterson v. Shumate*, _____U.S._____, 112 S. Ct. 2242, 2248 (1992). In ruling on the limitations issue

presented herein, two appeals courts have relied upon a statement posited as an "example" in the Senate Finance Committee report as the foundation for their conclusions that Congress intended the Subchapter S corporate's return to be the governing return for statute of limitations purposes only when the corporation itself is subject to tax liability. *Green v. Commissioner*, 963 F.2d 783, 790 (5th Cir. 1992); *Fehlhaber v. Commissioner*, 954 F.2d 653, 656 (11th Cir. 1992). That committee report states (S. Rep. No. 1983, 85th Cong., 2d Sess. (1958), *reprinted in* 1958-3 C.B. 922, 1147)(emphasis added):

> Notwithstanding the fact that an electing small-business corporation is not subject to the tax imposed by chapter 1 of the 1954 Code, such corporation must make a return for each taxable year in accordance with new section 6037 as added by subsection (c) of section 68 of the bill. **Such return will be considered as a return filed under section 6012 for purposes of the provisions of chapter 66, relating to limitations. Thus, for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that the corporation was not entitled to the benefits of subchapter S, will run from the date of filing of the return required under the new section 6037.**

The Fifth and Eleventh Circuits erred in viewing the words "for example" as setting forth the sole instance in which a Subchapter S corporation's return would commence the statute of limitations with respect to IRS audit adjustment

of Subchapter S income or loss. An "example" has never been an exclusive or exhaustive listing: *exempla illustrant non restringunt legum*. If "for example" means anything at all, it must refer to situations other than that referred to in the committee report's example, *i.e.*, an invalid Subchapter S election in which the Subchapter S corporation's tax return is treated as a corporate tax return. Both the Fifth and the Eleventh circuits erred in resorting to legislative history in the first place (because the three statutes are patently clear), and when doing so ignoring the Senate Finance Committee's "for example" language; that language undermines and precludes the very conclusions those two circuits reached.

The courts of appeals are trying to create law contrary to what Congress said. *Blanchard v. Bergeron*, 489 U.S. 87, 97-99 (1989). As stated by the Ninth Circuit (*Kelley v. Commissioner*, 877 F.2d 756, 759 (9th Cir. 1989)):

> If Congress had intended the example to swallow the language of the text, Congress could easily have written the statute to provide that the period of limitations will run from the date of filing of the return required under section 6037 *only* in instances of a subsequent determination that a corporation was not entitled to the benefits of Subchapter S.

B. The Second, Fifth and Eleventh Circuit Courts of Appeals in *Bufferd, Green* and *Fehlhaber* Have Rendered Surplusage Congress' Use of the Modifier "Any" in the Last Sentence of Section 6037.

The Ninth Circuit (in *Kelley*) has made the only interpretation of Section 6037 that gives effect to the adjective "any" that appears in the last sentence of Section

6037. "**Any** [Subchapter S corporation] return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012." (Emphasis added.) When Subchapter S was added to the Internal Revenue Code in 1958, "**any** return" included only two classes of returns: (i) the return of a validly electing Subchapter S corporation, and (ii) the return of a Subchapter S corporation that is taxable because of a defective Subchapter S election. (After 1966, when Subchapter S corporations were made taxable on certain transactions (footnote 9, *supra*), "any return" also referred to such Subchapter S corporations.) According to Section 6037, "any return" shall constitute a return for purposes of commencing the statute of limitations for adjustments made at the corporate level. No other genuine interpretation of the last sentence of Section 6037 is possible. This common-sense approach underscores the wisdom in the rule of statutory construction that statutes should not be construed to render any provision surplusage and that every word employed by Congress should be given effect. *E.g., United States v. Menasche*, 348 U.S. 528 (1955).

The conclusions reached by the Second, Fifth and Eleventh Circuits are possible only if "any" is read out of the text of Section 6037. For this additional reason, those Circuits' opinions are erroneous.

C. Congress Did Not, in Legislative History, Manifest an Intent to Override the Sweeping Statutory Language of the Last Sentence of Section 6037.

Through the use of the words "for example," the legislative history of Section 6037 sets forth one of several obvious illustrations of the application of the last sentence of

that section. Further, the statutory word "any" (in Section 6037 since 1958) is completely in harmony with "for example." In no event can this legislative history be interpreted as clearly expressed legislative intent that Section 6037's last sentence be limited to the sole situation in which the Subchapter S election was ineffective. "Absent a clearly expressed legislative intent to the contrary, [the statutory] language must ordinarily be regarded as conclusive." *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983), *citing Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The question in this case is whether Section 6037 means what it says, or whether the courts may rewrite Section 6037 so that it applies only in the instance in which the corporation itself owes a tax liability because the Subchapter S election is invalid. By the use of "for example," the Senate Finance Committee itself stated that the invalidity of the Subchapter S election was but one of several instances in which the last sentence of Section 6037 would be applicable.[15] Therefore, if the last sentence of Section 6037 is to be given any effect, it must mean what it literally says: that the statute of limitations on IRS audit adjustments to "any" Subchapter S return is governed by the corporate return filing date.

This result is not "absurd." Indeed, it is consistent with the purpose of statutes of limitations (*Rothensies v.*

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15 It is obvious, as is pointed out in Petitioner's main brief, that the Second, Fifth and Eleventh circuits legally erred in relying on the proposition that "for example" referred to two situations: (1) when the Subchapter S election was invalid, and (2) when the Subchapter S corporation is subject to net capital gains tax. The reason is that net capital gains tax was not imposed on Subchapter S corporations until eight years after the "for example" language was enacted. *See* Note 9, *supra*.

Electric Storage Battery Co., 329 U.S. 296, 301 (1946)):

> [Congress has regarded it as] ill-advised to have an income tax system under which there would never come a day of final settlement and which required both a taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, and recall details of all that goes into an income tax contest. * * * The theory is that even if one has a just claim, it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them.

As the Ninth Circuit aptly stated (*Kelley v. Commissioner*, 877 F.2d at 758):[16]

> The shareholder can defend against such an adjustment [by the IRS to a Subchapter S corporation's return] only by resort to the corporation's books and records. The statute of limitations exists, in part, so that after some time persons can be confident that their affairs are closed and they can dispose of old records. An S corporation should be entitled to the same finality as others, yet [pursuant to the government's argument] if any of the shareholders has given an extension of the statute of limitations to the IRS[,] the shareholder's ability to defend against the adjustment would depend upon whether the corporation has retained the records.

16 In *Brody v. Commissioner* (one of *amici curiae*), the IRS sent its proposed audit adjustment to Mr. Brody eight years after the Subchapter S corporation's year end. Because of the delay, Mr. Brody was unable to obtain the Subchapter S corporation's records.

CONCLUSION

For the reasons stated in *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989), in Petitioner's brief, and herein, the judgment of the United States Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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